

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d)  
of the Securities Exchange Act of 1934

CUMMINS ENGINE COMPANY, INC.  
\_\_\_\_\_

For the Quarter Ended June 29, 1997      Commission File Number 1-4949  
\_\_\_\_\_

Indiana

35-0257090

(State or Other Jurisdiction of  
Incorporation or Organization)

(IRS Employer Identification No.)

500 Jackson Street, Box 3005,

\_\_\_\_\_

Columbus, Indiana

47202-3005

(Address of Principal Executive Offices)

(Zip Code)

812-377-5000

(Registrant's Telephone Number)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the proceeding 12 months and (2) has been subject to such filing requirements for the past 90 days:

Yes   
No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date:

As of June 29, 1997, the number of shares outstanding of the registrant's only class of common stock was 42.0 million.

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CUMMINS ENGINE COMPANY, INC.  
CONSOLIDATED STATEMENT OF EARNINGS  
FOR THE SECOND QUARTER AND FIRST HALF  
ENDED JUNE 29, 1997 AND JUNE 30, 1996  
Unaudited

Millions, Except per Share Amounts	Second Quarter		First Half	
	1997	1996	1997	1996
Net sales	\$1,396	\$1,316	\$2,700	\$2,632
Cost of goods sold	1,072	1,016	2,090	2,016
Gross profit	324	300	610	616
Selling & administrative expenses	186	180	364	360
Research & engineering expenses	64	66	125	128
Net (income) expense from joint ventures and alliances	(2)	3	(9)	5
Interest expense	7	4	12	8
Other (income) expense, net	(5)	(15)	(12)	(18)
Earnings before income taxes	74	62	130	133
Provision for income taxes	21	18	36	40
Net earnings	\$ 53	\$ 44	\$ 94	\$ 93
Earnings per share	\$ 1.39	\$ 1.10	\$ 2.45	\$ 2.31
Cash dividends declared per share	.275	.25	.525	.50

CUMMINS ENGINE COMPANY, INC.  
CONSOLIDATED STATEMENT OF FINANCIAL POSITION  
Unaudited

Millions, Except per Share Amounts	6/29/97	12/31/96
<b>Assets</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 111	\$ 108
Receivables	805	669
Inventories	633	587
Other current assets	201	189
	1,750	1,553
Investments and other assets	304	326
Property, plant & equipment less accumulated depreciation of \$1,394 and \$1,375	1,396	1,286
Intangibles, deferred taxes and deferred charges	207	204
Total assets	\$3,657	\$3,369
<b>Liabilities and shareholders' investment</b>		
<b>Current liabilities:</b>		
Loans payable	\$ 38	\$ 93
Current maturities of long-term debt	46	39
Accounts payable	406	380
Other current liabilities	624	509
	1,114	1,021
Long-term debt	468	283
Other liabilities	752	753
<b>Shareholders' investment:</b>		
Common stock, \$2.50 par value, 47.8 and 43.9 shares issued	119	110

Additional contributed capital	1,100	929
Retained earnings	607	535
Common stock in treasury, at cost, 5.8 and 4.5 shares	(227)	(169)
Common stock held in trust for employee benefit plans, 3.7 shares	(178)	-
Unearned compensation (ESOP)	( 42)	( 46)
Cumulative translation adjustments	( 56)	( 47)
	<u>1,323</u>	<u>1,312</u>
Total liabilities and shareholders' investment	<u>\$3,657</u>	<u>\$3,369</u>

CUMMINS ENGINE COMPANY, INC.  
CONSOLIDATED STATEMENT OF CASH FLOWS  
Unaudited

Millions	First Half Ended	
	6/29/97	6/30/96
Cash flows from operating activities:		
Net earnings	\$ 94	\$ 93
Adjustments to reconcile net earnings to net cash from operating activities:		
Depreciation and amortization	80	76
Restructuring actions	( 10)	( 23)
Accounts receivable	(140)	(111)
Inventories	( 49)	( 64)
Accounts payable and accrued expenses	74	62
Income taxes payable	10	21
Other	8	( 2)
Total adjustments	<u>( 27)</u>	<u>( 41)</u>
Net cash provided by operating activities	<u>67</u>	<u>52</u>
Cash flows from investing activities:		
Property, plant and equipment:		
Additions	(205)	(84)
Disposals	8	18
Investments in joint ventures and alliances	2	40
Disposition of business activities	80	11
Other	( 3)	7
Net cash used in investing activities	<u>(118)</u>	<u>( 8)</u>
Net cash flows (used for) provided from operating and investing activities	<u>( 51)</u>	<u>44</u>
Cash flows from financing activities:		
Proceeds from borrowings	201	160
Payments on borrowings	( 10)	( 8)
Net borrowings under credit agreements	( 52)	(44)
Repurchase of common stock	( 58)	(21)
Dividend payments	( 22)	(20)
Other	( 4)	( 2)
Net cash provided from financing activities	<u>55</u>	<u>65</u>
Effect of exchange rate changes on cash	<u>( 1)</u>	<u>-</u>
Net change in cash and cash equivalents	3	109
Cash & cash equivalents at beginning of year	108	60
Cash & cash equivalents at end of first half	<u>\$111</u>	<u>\$169</u>

Note 1. Accounting Policies: The Consolidated Financial Statements for the interim periods ended June 29, 1997 and June 30, 1996 have been prepared in accordance with the accounting policies described in the Company's Annual Report to Shareholders and Form 10-K. Management believes the statements include all adjustments of a normal recurring nature necessary to present fairly the results of operations for the interim periods. Inventory values at interim reporting dates are based upon estimates of the annual adjustments for taking physical inventory and for the change in cost of LIFO inventories.

Note 2. Income Taxes: Income tax expense is reported during the interim reporting periods on the basis of the estimated annual effective tax rate for the taxable jurisdictions in which the Company operates.

Note 3. Long-term Debt: In February 1997, the Company issued \$120 million of 6.75 percent debentures that mature in 2027. Net proceeds were used principally to repay commercial paper indebtedness incurred to repurchase shares of common stock. Holders of the debentures have a 1-time option in 2007 to redeem the debentures. The Company also has a recall right after ten years.

In July 1997, the Company filed a Shelf Registration Statement with the Securities and Exchange Commission in the amount of \$250 million to issue from time to time debt securities, preferred stock, preference stock, common stock or warrants at prices and on terms to be determined at the time of sale.

Note 4. Common Stock: In January 1997, the Company issued 3.75 million shares of its common stock to an employee benefits trust to fund obligations of employee benefit and compensation plans, principally retirement savings plans. Shares of the common stock held by this trust are not used in the calculation of the Company's earnings per share until distributed from the trust and allocated to a benefit plan. The Company also repurchased 1.3 million shares of its common stock from Ford Motor Company in January 1997 and was authorized by the Board of Directors to repurchase an additional 1.7 million shares from time to time in the open market.

In April 1997, the Company announced an increase in its quarterly common stock dividend from 25 cents per share to 27.5 cents, effective with the dividend payment in June 1997.

NOTE 5. Earnings per Share: Earnings per share of common stock are computed by dividing net earnings by the weighted-average number of common shares outstanding during the period. The weighted-average number of shares, which excludes shares of stock held by the employee benefits trust until distributed and allocated to a benefit plan, was 38.4 million in the second quarter and first half of 1997. The weighted-average number of shares was 40.1 million in the second quarter of 1996 and 40.2 million shares in the first half of 1996. The Financial Accounting Standards Board has released a new accounting rule on the calculation of earnings per share that is effective at year-end 1997. This rule, which does not permit early adoption, is not expected to have a material effect on the Company's reported earnings per share.

CUMMINS ENGINE COMPANY, INC.  
MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
RESULTS OF OPERATIONS, CASH FLOW AND FINANCIAL CONDITION

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OVERVIEW

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Record sales of \$1.4 billion in the second quarter of 1997 were 6 percent higher than the second quarter of 1996. The increase was primarily due to record quarterly sales to industrial markets and improvements in the heavy-duty truck market. For the first half, the Company's sales were \$2.7 billion, 3 percent higher than the first half of 1996.

The Company shipped 174,500 engines in the first half of 1997, the same as the first half of 1996. Increased shipments for industrial, power generation and bus markets in the first half of 1997 offset declines for truck markets as the Company's broader market and geographical revenue base continued to pay off.

	Second Quarter		First Half	
	1997	1996	1997	1996
Engine Shipments				

Midrange	62,800	61,100	125,800	123,600
Heavy-duty	23,000	21,900	43,800	46,400
High-horsepower	2,600	2,400	4,900	4,500
Total	<u>88,400</u>	<u>85,400</u>	<u>174,500</u>	<u>174,500</u>

Net earnings were \$53 million, or \$1.39 per share, in the second quarter of 1997, compared to \$44 million, or \$1.10 per share, in the second quarter of 1996. This was the first time since the second quarter of 1995 that net earnings exceeded the year-ago quarter. For the first half of 1997, net earnings were \$94 million, or \$2.45 per share, compared to \$93 million, or \$2.31 per share, in the first half of 1996.

#### RESULTS OF OPERATIONS

The percentage relationships between net sales and other elements of the Company's Consolidated Statement of Earnings for the comparative reporting periods were:

	Second Quarter		First Half	
	1997	1996	1997	1996
Percent of Net Sales				
Net sales	100.0	100.0	100.0	100.0
Cost of goods sold	76.8	77.2	77.4	76.6
Gross profit	23.2	22.8	22.6	23.4
Selling and administrative expenses	13.3	13.7	13.5	13.7
Research and engineering expenses	4.6	5.0	4.6	4.9
Net (income) expense from joint ventures and alliances	(.1)	.2	(.3)	.2
Interest expense	.5	.3	.4	.3
Other (income) expense, net	(.4)	(1.1)	(.4)	(.8)
Earnings before income taxes	5.3	4.7	4.8	5.1
Provision for income taxes	1.5	1.4	1.3	1.6
Net earnings	3.8	3.3	3.5	3.5

#### Net Sales

Sales for each of the Company's markets for the comparative reporting periods were:

	Second Quarter		First Half	
	1997	1996	1997	1996
Dollars in Millions				
Automotive:				
Heavy-duty truck	\$ 331	\$ 310	\$ 626	\$ 674
Midrange truck	143	154	275	315
Bus and light commercial vehicles	152	151	323	310
Power generation	302	308	577	560
Industrial	263	209	520	411
Filtration and other	205	184	379	362
Net sales	<u>\$1,396</u>	<u>\$1,316</u>	<u>\$2,700</u>	<u>\$2,632</u>

#### Automotive

Sales of \$331 million to the heavy-duty truck market in the second quarter of 1997 were 7 percent higher than a year ago, due to increased engine shipments in international markets. International engine shipments were almost 60 percent higher than the second quarter of 1996, due to stronger demand in Mexico. In North America, engine shipments were 3 percent lower than the second quarter of 1996 due to a smaller market size. Compared to the first half of 1996, sales of \$626 million to the heavy-duty truck market were 7 percent lower in 1997, due to the lower market size in North America. However, order intake rates for the North American market have been trending upward, and engine shipments in the second quarter were 13 percent higher than the first quarter of 1997.

In the second quarter and first half of 1997, sales for the midrange truck market were 7 percent and 13 percent lower than the comparative periods of 1996, due primarily to a decrease in demand for medium-duty trucks in North America. Midrange engines for international markets were 21 percent higher than the second quarter of 1996 and 16 percent higher than the first half of 1996. The increase in 1997 was in Brazil, Southeast Asia and Mexico.

In the bus and light commercial vehicles market, sales of \$152 million in the second quarter were level with the second quarter of 1996. The Company's sales to Chrysler were negatively impacted in the second quarter of 1997 because of a 4-week work stoppage at Chrysler. Engine shipments to Chrysler were 13 percent below the second quarter of 1996. However, demand for the Company's engines in North American bus markets remained strong in the second quarter of 1997, with engine shipments 25 percent higher than the second quarter of 1996 and 11 percent higher than the first half of 1996.

#### Power Generation

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Sales to the power generation market continued to represent over 20 percent of the Company's net sales in the second quarter and first half of 1997. Sales of \$302 million in the second quarter of 1997 were 2 percent below the second quarter of 1996. Power generation sales of \$577 million in the first half of 1997 were 3 percent higher than the 1996 level.

#### Industrial

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Record sales of \$263 million to industrial markets were 26 percent higher than second-quarter 1996, reflecting strong sales for construction equipment in North America and for international agricultural markets. Shipments for marine markets were 37 percent higher than the year-ago quarter.

#### Filtration and Other

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Sales of \$205 million in the second quarter and \$379 million in the first half for filtration and other products were 11 percent and 5 percent higher than the respective periods of 1996. The increase in 1997 was due primarily to higher sales of filtration products and an improvement in European markets for turbochargers.

#### Gross Profit

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In the second quarter of 1997, the Company's gross profit percentage was 23.2 percent of net sales compared to 22.8 percent in the second quarter of 1996. In the second quarter of 1997, the company benefited from higher volume absorption and lower expenses associated with the restructuring actions. In the first half of 1997, the Company's gross profit percentage was 22.6 percent of net sales, compared to 23.4 percent in 1996. Product coverage expense was 2.7 percent of net sales in the second quarter and first half of 1997, compared to 2.9 percent in the second quarter and 2.7 percent in the first half of 1996.

#### Operating Expenses

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Selling and administrative expenses of \$186 million in the second quarter of 1997 and \$364 million in the first half were 13.3 percent and 13.5 percent of net sales, respectively, compared to 13.7 percent of net sales in the second quarter and first half of 1996. The increase in absolute dollars in 1997 was primarily due to expenditures for new product launches, software and systems development, and volume-related marketing programs. In the second quarter and first half of 1997, research and engineering expenses of \$64 million and \$125 million, respectively, were slightly lower than the comparative periods of 1996.

Net income from joint ventures and alliances was \$2 million in the second quarter and \$9 million in the first half of 1997. The increase in income over 1996 was due higher earnings and royalties from KCL and the joint ventures with Komatsu and Dongfeng and lower start-up losses at the Company's joint venture with Wartsila.

#### Interest and Other Income and Expense

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Interest expense of \$7 million in the second quarter and \$12 million in

first half of 1997 was higher than the comparable periods of 1996 due to a higher level of debt in 1997. In the second quarter of 1997, other income was \$10 million lower than the year-ago quarter, which included capital gains associated with various asset disposals.

#### Provision for Income Taxes

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The estimated effective tax rate for 1997 is 28 percent. This is lower than the US statutory tax rate of 35 percent, primarily because of lower taxes on US export sales and the incremental research tax credit that expired on May 31, 1997.

#### CASH FLOW AND FINANCIAL CONDITION

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Key elements of the Consolidated Statement of Cash Flows were:

Dollars in Millions	First Half	
	1997	1996
Net cash provided by operating activities	\$ 67	\$ 52
Net cash used for investing activities	(118)	(8)
Net cash flows (used for) provided from operating and investing activities	( 51)	44
Net cash provided from financing activities	55	65
Effect of exchange rate changes on cash	( 1)	-
Net change in cash and cash equivalents	\$ 3	\$109

During the first half of 1997, the Company generated cash flows from operating activities of \$67 million, compared to \$52 million in the first half of 1996. Investing activities required net cash resources of \$118 million in the first half of 1997. Capital expenditures were \$205 million in the first half of 1997, compared to \$84 million in the first half of 1996. The increased level of expenditures in 1997 was related to continued investments for new products. At the end of the second quarter of 1997, the Company sold its vibration attenuation business to Simpson Industries for approximately \$74 million. The sale of this business, effective June 29, is part of the Company's continuing restructuring program announced previously and had no net effect on reported results in the second quarter.

Net cash provided from financing activities was \$55 million in the first half of 1997. As disclosed in Note 3 to the Consolidated Financial Statements, the Company issued \$120 million in debentures under its shelf registration statement in February 1997.

In January 1997, the Company repurchased 1.3 million shares of its common stock from Ford Motor Company and was authorized by the Board of Directors to repurchase an additional 1.7 million shares in the open market. In January 1997, the Company also issued 3.75 million shares of its common stock to an employee benefits trust.

In April 1997, the Company announced a 10-percent increase in its quarterly common stock dividend from 25 cents per share to 27.5 cents, effective with the dividend payment in June 1997.

#### FORWARD-LOOKING STATEMENTS

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The Company has included certain forward-looking statements in this Management's Discussion and Analysis of Results of Operations, Cash Flow and Financial Condition. These statements are based on current expectations, estimates and projections about the industries in which the Company operates, management's beliefs and various assumptions made by management which are difficult to predict. Among the factors that could affect the outcome of the statements are general industry and market conditions and growth rates. Therefore, actual outcomes and their impact on the Company may differ materially from what is expressed or forecasted. The Company undertakes no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

#### PART II. OTHER INFORMATION

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Item 6. Exhibits and Reports on Form 8-K:

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- (a) See the Index to Exhibits on Page 13 for a list of exhibits filed herewith.
- (b) The Company was not required to file a Form 8-K during the second quarter of 1997.

Signatures

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Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CUMMINS ENGINE COMPANY, INC.

By: /s/Rick J. Mills

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Rick J. Mills  
Vice President - Corporate Controller  
(Chief Accounting Officer)

July 21, 1997

CUMMINS ENGINE COMPANY, INC.

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INDEX TO EXHIBITS  

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- 11 Schedule of Computation of Per Share Earnings for the Second Quarter and First Half Ended June 29, 1997 and June 30, 1996 (filed herewith)
  
- 27 Financial Data Schedule (filed herewith)

CUMMINS ENGINE COMPANY, INC.  
 SCHEDULE OF COMPUTATION OF PER SHARE EARNINGS  
 FOR THE SECOND QUARTER AND FIRST HALF  
 ENDED JUNE 29, 1997 & JUNE 30, 1996

Millions, Except per Share Amounts	Second Quarter		First Half	
	Weighted Average Shares	Net Earnings	Weighted Average Shares	Net Earnings
<u>1997</u>				
Net earnings	38.3	\$ 53	38.3	\$ 94
Options	.1	-	.1	-
	-----	-----	-----	-----
Used in the determination of earnings per share	38.4	\$ 53	38.4	\$ 94
	-----	-----	-----	-----
Primary and fully diluted earnings per share		\$1.39		\$2.45
		-----		-----
		-----		-----
<u>1996</u>				
Net earnings	40.0	\$ 44	40.1	\$ 93
Options	.1	-	.1	-
	-----	-----	-----	-----
Used in the determination of earnings per share	40.1	\$ 44	40.2	\$ 93
	-----	-----	-----	-----
Primary and fully diluted earnings per share		\$1.10		\$2.31
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